



# 2011 CALIFORNIA VOLUNTEER REFERENCE MANUAL – General Information

auxiliary military branch) during 2011.

- Was a California nonresident for the entire year with no California source income.

The exceptions above require income splitting. Since income splitting rules are complex and outside the scope of the VITA/TCE volunteer program, refer these clients to the Franchise Tax Board or, if military, to their Staff Judge Advocate's Office.

Completely fill in the circle for the filing status that applies to your clients.

## Claimed as a Dependent

Completely fill in the circle on line 6 if your client, or their spouse/RDP, meet the dependency rules on someone else's tax return.

## Exemptions

### Personal

Find the exemption credit amounts in the exemption section of Form 540.

If the **circle on line 6 is blank** and the filing status is:

Single, enter	<b>1</b>
Married/RDP filing jointly, enter	<b>2</b>
Married/RDP filing separately, enter	<b>1</b>
Head of Household, enter	<b>1</b>
Qualifying widow(er), enter	<b>2</b>

If you **did** check the circle on line 6 and the filing status is:

- Single, married/RDP filing separately, head of household, or married/RDP filing jointly, and both your client and their spouse/RDP can be claimed as a dependent, **enter 0**.
- Married/RDP filing jointly and only your client or their spouse/RDP can be claimed as a dependent, **enter 1**.

Then, multiply this number by \$102 and enter the amount on line 7 of Form 540.

### Blind

Claim an additional personal exemption credit if your client, or spouse/RDP if filing jointly, is visually impaired. If this exemption is claimed for the first time, attach a doctor's statement verifying the visual impairment to the **back** of the tax return.



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*Visually impaired* means: "Vision is no better than 20/200 while wearing glasses or contact lenses, or that the field of vision is not more than 20 degrees." Enter 1 if your client qualifies or 2 if both the client and their spouse/RDP qualify. Multiply this number by \$102 and enter the amount on line 8 of Form 540.

**Important Info:** This exemption credit cannot be taken if your client can be claimed as a dependent on someone else's tax return.

## Senior

Claim an additional personal exemption credit if your client, or their spouse/RDP, if filing jointly, is 65 years of age or older by December 31, 2011. Enter 1 if your client qualifies or 2 if both your client and spouse/RDP are 65 or older. Multiple this number by \$102 and enter the amount on line 9 of Form 540.

If your clients' 65th birthday is on January 1, 2012, they are considered age 65 on December 31, 2011.

If your client can be claimed as a dependent on someone else's return, they may not claim this exemption credit.

**Important Note:** You must check the "blind" box located on the main information screen and/or enter your client's birthdate on the main information screen in order for the blind and senior exemption credits to automatically enter on the state tax return.

## Dependents

An exemption credit is allowed for each dependent. Write the name and relationship of each dependent in the appropriate space.

Listed dependents must be the same on both federal and state tax returns.

Count the number of dependents listed, and enter the total in the appropriate boxes on the forms. Multiply the number of dependents by \$315 and enter the amount on line 10 of Form 540.

**Important Info:** The Dependent Exemption Credit on Form 540 2EZ is included in Form 540 2EZ tax tables.

## Income Adjustments

**These are the adjustments available on the California Form 540/540A. Refer to the Form 540 section for additional information and income adjustments available.**

## State Income Tax Adjustment

California does not tax state income tax refunds. Enter the amount of any



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state income tax refund on Form 1040, line 10, as a subtraction adjustment to income on the California tax return.

## **Unemployment Compensation Adjustment**

California does not tax unemployment compensation or paid family medical leave reported on federal Form(s) 1099-G and shown on the federal tax return. Enter the amount of taxable unemployment compensation or paid family medical leave on Form 1040, line 19, as a subtraction adjustment to income on the California tax return.

## **Social Security Benefits, Tier 1 and Tier 2 Railroad Retirement Benefit Adjustments**

California does not tax:

- Social security benefits and equivalent tier I railroad retirement benefits on Form 1040, line 20b.
- Tier 2 railroad retirement benefits on Form 1040, line 16b.

Enter the total taxable amounts of the income types above on your client's federal tax return as a subtraction adjustment to income on the California return.

Adjust the income types above on California Adjustments – Residents Form CA(540) for Form 540 filers and on Page 1, line 14, for Form 540A filers.

**Important Note:** If your client has a 1099R with tier I or tier 2 income, make sure you "X" the "Railroad" box when entering the Form 1099R to indicate taxable income from this 1099R qualifies for subtraction on the California Schedule CA (540).

## **California Nontaxable Interest or Dividend Income Adjustment**

California does not tax interest income from:

- United States savings bonds
- United States Treasury Bills
- Any other bonds or obligations of the United States, U.S. territories, and government agency obligations specifically exempt by federal law.

Enter nontaxable interest amounts included on Form 1040, line 8a, as a subtraction adjustment to income on the California tax return. Adjust the income types above on California Adjustments – Residents Form Schedule CA(540) for Form 540 filers and on Page 1, line 14, for Form 540A filers.

## **Interest from municipal or state bonds from a state other than California:**

Report this interest, taxable by California but not by federal, on Form Schedule CA (540). If you identify this type of interest income as tax exempt on your



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client's federal return, add it back on their state return. Enter the federal tax-exempt interest on line 8, column C, Form Schedule CA (540).

## **Exempt-interest dividends from mutual funds:**

Certain qualified mutual funds pay "exempt interest dividends." If at least 50 percent of their assets, at the end of each quarter, consist of tax-exempt government obligations, including tax-exempt government obligations of the state of California and its' municipalities, that amount of dividend is exempt from California tax. Find the tax-exempt portion of the dividend on your client's annual statement. Enter the California exempt-interest amount that exceeds the federal exempt-interest amount on Form Schedule CA (540), line 8, column B.

Tax exempt interest dividends include:

- Exempt federal obligations, or
- California state or local obligations.

For California purposes, federal and California state obligations may be combined to meet the 50 percent test. California tax exempt obligations are different than federal. The differences are:

- Federal – State or local obligations of any state.
- California – California state or local obligations. U.S. federal obligations.

**Important Info:** The mutual fund determines the tax-exempt amount for federal tax purposes and sends a statement to the taxpayer. The federal amount will be correct for California if the exempt-interest dividends are from California state and local obligations.

Only federal obligations that would be exempt from California taxation if held by the individual taxpayer qualify for tax-exempt treatment.

The amount designated by the mutual fund as an exempt interest dividend may contain items that are not exempt from California tax (e.g. non-California state obligations or non-deductible interest expenses). In this case, only a percentage of the dividend will be exempt for California purposes.

**Important Note:** On the federal Schedule B, interest statement, enter a "+" in the state adjustment column, for interest that needs to be added to the state tax return. Place a "-" in the column for interest that is nontaxable to the state and needs to be subtracted on the state tax return.

## **California Distributions**

Although the taxing method of IRA distributions is generally the same for California and federal calculations, there may be differences in the taxable amount depending



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on the year the client made the contribution.

If your client or their spouse/RDP contributed to an IRA in 1975, or 1982 through 1986, you may need to make an adjustment. California and federal deduction rules differed during these years. The client may owe less California tax on the distribution amount.

Consider an IRA fully taxable if your client took the full deduction at the time of the contribution. If the IRA contribution was partially or fully nondeductible, then the nondeductible contribution is not taxed when your client begins taking distributions.

Since California law differs from federal law, complete the “IRA Adjustment Worksheet” in this chapter to determine California basis.

## **1975:**

IRA deductions disallowed for California. Federal allowed an IRA deduction up to \$1,500.

## **1982 through 1986:**

California and federal law differed. The maximum federal individual deduction equaled \$2,000. Active participants in qualified and government retirement plans, and persons who contributed to tax-sheltered annuities, qualified for the federal deduction. For California, the maximum deduction equaled the lesser of \$1,500 or 15% of earned income with an additional deduction for a “nonworking spouse,” up to an overall limit of \$1,750. California disallowed all IRA deductions if an individual was an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity.

## **1987 through present:**

California law conforms to the federal law. Therefore, if your clients made an IRA contribution during those years, no adjustment is necessary.

## **California residents who were formerly nonresidents:**

California law changed for tax years beginning on or after January 1, 2002.

Under the prior law, when your client became a California resident, they received a stepped-up basis in their IRA equal to their annual contributions made while a nonresident, plus their IRA earnings while a nonresident. A nonresident’s IRA basis was carried over until fully recovered. But now, under the new law, they no longer have this stepped-up basis.

The law treats a former nonresident as if they were a resident for all prior years for all items of deferred income, which includes IRAs. Therefore, a former nonresident claims a basis only for nondeductible contributions under California law for a California resident. This applies only to contributions made prior to 1987.



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If your client became a California resident prior to 2002 with an unrecovered stepped-up basis carryover for 2002, restate their IRA basis using the new law. If a client does not recover basis from the initial distribution, the client may amend for applicable years. Otherwise, any unrecovered basis is lost.

**Important Note:** For more information, see FTB Pub.1005, *Pension and Annuity Guidelines*.

**Below is an example of how to figure a California Basis Adjustment**

<b>Basis Worksheets – Worksheet I Figuring California Basis/Adjustment to Federal AGI</b>	
<b>Part A - Pre-1987 California Basis</b> (If you have already computed your California basis as of 12/31/2010, or have always been a California resident, skip to Part B.)	
1. Enter your total federal deductions claimed prior to 1987.	1.
2. Enter total California deductions claimed prior to 1987 (or the deductions you could have claimed if you had been a California resident).	2.
3. Total California basis (subtract line 2 from line 1).	3.
4. Enter your California basis recovered in prior years.	4.
5. California basis as of 12/31/2010. Subtract line 4 from line 3.	5.
<b>Part B – Adjustments to Federal AGI and Remaining Pre-1987 California Basis</b>	
1. Enter your taxable distribution from your Federal Form 1040, line 15b (or line 16b).	1.
2. Enter your California basis as of 12/31/2010.	2.
3. Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540), line 15b, or line 16b.	3.
4. Remaining California basis as of 12/31/2011. Subtract line 3 from line 2.	4.

Enter Total California basis from information above or client's records:	1. \$900
Enter California basis recovered in prior years:	2. \$0
California basis as of 12/31/2011:	3. \$900
Enter client's taxable distribution from Form 1040, line 15b:	4. \$500
Enter client's basis as of 12/31/2011 (from line 3 above):	5. \$900
Enter the smaller of line 4 or line 5. Enter this amount on Schedule CA (540), line 15b:	6. \$500
Remaining California basis as of 12/31/2011, subtract line 6 from line 5:	7. \$400



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**Use this IRA Adjustment Worksheet to Calculate Your Client's IRA California Basis.**

## **Contributions and Deductions by Year**

Your client must be able to provide information to complete the chart in order for you to determine whether an adjustment is necessary. If your client does not have this necessary information, no adjustment can be made.

<b>Year</b>	<b>Contributions</b>	<b>Federal Deductions</b>	<b>State Deductions</b>
1975			
1982			
1983			
1984			
1985			
1986			
<b>Total</b>			
	<b>(A)</b>	<b>(B)</b>	<b>(C)</b>

If your client can provide the necessary information, subtract total California Deductions (C) from total Federal Deductions (B). This amount is your client's California basis. If there is no difference between B and C, there is no adjustment on Form 540A, line 13e; or Schedule CA (540), line 15.

## **Basis of an Inherited IRA**

An inherited IRA is considered inherited income, not inherited property. The IRA basis is not stepped up to fair market value at the date of death. The beneficiary's basis in the IRA is the same as the decedent's basis in the IRA.

## **California Pension and Annuity Adjustments**

California and Federal laws generally treat pension and annuity income the same. However, if any of the following apply, your client may have an adjustment on the California tax return:

- They receive a federal Form RRB 1099-R for tier 2 railroad retirement benefits and you included all or part of these benefits as taxable income on the federal tax return.
- They received a retirement annuity between July 1, 1986, and January 1, 1987, and elected to use the three year rule for California purposes. The federal taxable amount is less than the California taxable amount.
- They receive federally nontaxable foreign social security income.